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SUBJECT: AUSTRALIA ROLLS OUT NEW STIMULUS PLAN

REF: A. PERTH 7

[1](#)B. 08 CANBERRA 1036

[1](#)C. 08 CANBERRA 1121

[1](#)D. CANBERRA 95

Classified By: ECONCOUNS E KAGAN, REASONS 1.4 B, D

[1](#)1. (SBU) SUMMARY. Responding to increasingly dire economic forecasts, PM Kevin Rudd announced February 3 a A\$42 billion (US\$26 billion) economic stimulus package, the second in four months, equal to about 4% of GDP. It is largely focused on rapid spending on education infrastructure and cash payments to low- and middle-income families. Further emphasizing the challenges facing Australia despite still low unemployment of 4.5%, the Reserve Bank of Australia today cut interest rates 100 basis points to 3.25%. The Government announced the budget would go into deficit, and reduced predictions for growth. These moves come at the end of three solid weeks of bad economic news in Australia which has changed the debate from whether Australia will go into recession to how bad will the recession be. The Government's aggressive action may not be enough to mitigate the worst of the downturn but does reflect a desire to be seen to be doing whatever it can to limit the damage. End Summary.

THE BAD NEWS KEEPS COMING

[1](#)2. (U) There has been nothing but bad news for the Australian economy over the past two weeks. The IMF again revised downward its estimate of Australian growth for 2009. Originally around 3%, they now predict the Australian economy will contract 0.2% for the year. The word "recession" is now a regular feature in the Australian economic and political debate. An Australian index for job advertisements slumped in December to levels last seen in the recessions of 1991 and 1982, and is expected to worsen in January. Layoffs - including a huge cut of 3300 domestic jobs by resource giant BHP Billiton (ref A) - have begun, various mining projects are being delayed and economists are predicting that unemployment (at 4.5% in December) could go as high as 9%. Australian exports to China are predicted to drop by one-third as China slows down. Even what would be seen usually as good news - a trade surplus in December - was soured by the fact that it was down by over half from two months earlier; with commodity prices likely to drop further in 2009 as contracts signed during the boom end, that commodity-driven surplus is likely to disappear no later than midyear.

13. (SBU) PM Rudd and Treasurer Wayne Swan are no longer coy or evasive about the prospects for the budget going into deficit. Now they are stressing that it will go into deficit, in a big way. Rudd and Swan over the past few days have stressed that the predicted deficit will be A\$115 billion (US\$72 billion at current A\$1 = US\$.635 exchange rate) over the next four years, about a tenth of the estimated tax take over that period. A drop in collection of corporate taxes makes up A\$50 billion of that shortfall. While admitting that the budget will go in deficit, Rudd has clearly decided that attack is the best defense. He has clearly decided that attack is the best defense. He has begun to aggressively criticize the leader of the opposition, Malcolm Turnbull, for his "neo-liberal" economic policies (never mind that Turnbull is distinctly to the left of former PM John Howard and is viewed with suspicion by some of his more conservative Liberal Party colleagues). Rudd also is publishing on February 4 an 8000-word article on the global financial crisis in the Australian magazine "The Monthly", which in addition to describing how the global crisis began, blames free market fundamentalism for creating the conditions for the banking and economic crisis.

GOA UNVEILS SECOND STIMULUS PACKAGE

14. (U) On February 3, the Rudd government announced a new A\$42 billion (US\$26.5b) "National Building and Jobs Plan" - double the stimulus package from November (ref B). Swan said the new legislation was designed to "cushion the effects of the global economic crisis" by putting this money into education and community infrastructure, public housing, business tax breaks and one-off cash payments. The GOA said it would "support and sustain" over 90,000 jobs, boost economic growth b 0.5% of GDP over the course of the 2008-2009 fiscal year, keeping overall growth for the current fiscal year at 1%. In the announcement, the GOA said it was forecasting unemployment to rise to 7% next year.

CONSTRUCTION SPENDING

15. (U) According to GOA data, A\$15 billion (US\$9.5b) will go into public schools, giving each A\$200,000 cash for maintenance, upgrading infrastructure such as libraries, and building 500 new science laboratories and language centers in schools with a demonstrated need. The plan would build or upgrade libraries and lecture halls in every public primary school in Australia. The GOA will spend A\$6.6 billion to pay for over 20,000 new public houses and 800 Department of Defence houses to be built and 2500 others upgraded. It will provide free insulation to 2.7 million homes, which the GOA says could cut A\$200 from home energy bills and reduce greenhouse gas emissions by 49.4 million tons by 2020. Small businesses will be able to access A\$2.7 billion to bring forward capital maintenance.

CASH HANDOUT

16. (U) The GOA will give a second cash handout (first was in December, ref B) totaling A\$12.7 billion (US\$8b) to about 10 million people, aimed at low- and middle-income households, farmers, single-income families, and students. Those earning less than A\$100,000 a year will receive a tax bonus of up to A\$950 (US\$600) at a cost of A\$8.2 billion (US\$5b). The GOA will also give cash payments of A\$950 in March to single-income families, farmers facing hardship due to drought, parents with children in school (2.8 million children), and students and unemployed returning to school.

17. (SBU) In their roll-out of the stimulus, the Rudd Government, making the best out of a necessity and trying to undercut the opposition which continues to call for tax cuts to be the focus of economic policy, said it would be "irresponsible" not to act now to try to mitigate damage from

the global downturn. Rudd and Swan again said they were committed to a surplus over the course of the business cycle.

GOVERNMENT VIEW: SPEED IS KEY

¶18. (C/NF) Stephen Kennedy, Chief Macroeconomic Advisor to PM Kevin Rudd, told us February 3 that the Government picked the largest of several stimulus options, but one focused on "getting money out the door and into circulation as quickly as possible." Kennedy said that the school construction component will require coordination with State governments, but that the plans have already been prepared. He said that the payments are controversial, with critics arguing that the Government's last stimulus payments were largely saved rather spent. Kennedy acknowledged that some were saved, while arguing that the increase in December retail sales (about 2.4% over December 2007) and the continuing strength of retail employment through the end of December are due in part to the stimulus payments as well as the greater optimism they generated among retailers. Australia faces very serious challenges and even a stimulus package of this magnitude may not be enough to avert a severe downturn. That said, Kennedy expressed confidence that the latest spending will help cushion the downturn in the coming 12 months.

UPDATED ECONOMIC OUTLOOK - DOWN

¶19. (SBU) The GOA said growth will be 1% for 2008-09 (July 1-June 30), and 0.75% for 2009-10 - more optimistic than the IMF but down significantly from what they predicted in the mid-year economic outlook (ref C), 2% in 2008-09 and 2.25% for 2009-10. Including this stimulus package, the GOA will face a deficit of A\$22.5 billion, or 1.9% of GDP which Rudd and Swan noted, compares well with the 7% average forecast for advanced economies.

RESERVE BANK SLASHES RATES AGAIN

¶110. (U) Shortly after the stimulus roll-out, the Reserve Bank of Australia (RBA) at its monthly meeting decided to cut the cash rate 100 basis points, to 3.25%, to try to cushion the economy from the effects of the global economic downturn. This is the fourth such move since early September, when the cash rate stood at 7.25% following a long round of rate hikes to dampen inflation - last year's problem. Governor Glenn Stevens in his statement again noted the significant deterioration in global economic conditions in late 2008, downturns in major economies and greatly reduced growth in China. He described the outlook for the global economy as the weakest for many years. He noted that the Australian economy has been affected, albeit less than in other economies. Stevens said the Australian financial sector remains sound, but the financial turmoil of the past year and drops in commodity prices have hit confidence and prospects for growth of demand.

¶111. (SBU) This move was as expected, although some were urging a 1.5% cut as done recently in New Zealand. The RBA decision puts the official cash rate at its lowest level ever. The RBA has been aggressive in using its buffer (the 7.25% rate at the beginning of September); given the need for Australia to maintain some sort of reasonably significant, positive interest rate to finance its current account deficit, it is probably approaching the lowest level where the RBA would feel comfortable.

COMMENT

¶112. (SBU) The RBA 100 basis point cut was expected and uniformly seen as the appropriate move given dropping growth rates, contracting credit availability, rising unemployment, and poor consumer and business confidence. The Rudd Government's stimulus package looks well designed to save

jobs - "support and sustain" jobs, not "create" them per their statement. Treasury still predicts up to 300,000 jobs could be lost over the year. Like the move to help the commercial sector last week (ref D), this will provide a boost to the Australian construction sector and related areas; the Housing Industry Association was very quick to sing the Rudd Government,s praises. Like the previous stimulus package, the various A\$950 bonuses are targeted to groups with a greater propensity to spend - although the Treasury has acknowledged that a significant proportion of the payments that went out in early December were saved by consumers rather than spent.

¶13. (SBU) Comment, Continued: Politically, the Rudd
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Government is determined to give the impression that it is doing all it can to stop or at least soften a recession and the impact on working Australians - and it has been effective so far in doing so. Australia has only limited means to limit the impact of a major economic downturn the economic impact, given the global economic conditions that this medium-to-small, open, trade exposed and commodity-based economy must deal with. All of its major trade partners are either in recession, or for China, suffering from the practical equivalent in significantly diminished growth. Australia entered this economic crisis unusually well-positioned, with high interest rates, significant budget surpluses, and low unemployment. Today, the GOA and the RBA have fired a volley of cash and liquidity they hope will prop up the economy. But both the RBA and the GOA have now used a significant portion of their monetary and fiscal ammunition - and recession will probably strike Australia nevertheless.

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